Lost in Space: The Search for Democratic Socialism in the Real World, and how I ended up halfway around the globe from where I began

Executive Summary. With the first Democratic debate coming up this week, I thought it was a good time to share the following analysis. At the California Democratic Party Convention earlier this month, the former two-term Governor of Colorado was booed for saying that “socialism is not the answer”. The crowd has company: recent surveys cite US college students having more favourable views of socialism than capitalism. When asked about failed 20th century socialist experiments, respondents insist they’re talking about democratic socialism instead. Fair enough, but before the world’s largest economy adopts democratic socialism, let’s see how it’s working out elsewhere. That’s where it gets murkier: such societies are not easy to find.

Some point to Nordic countries as democratic socialism in action, but some Nordics object to this, such as Danish Prime Minister Rasmussen: “Some in the US associate the Nordic model with some sort of socialism. Therefore, I would like to make one thing clear. Denmark is far from a socialist planned economy. Denmark is a market economy”. Our models back him up: while Nordic countries have higher taxes and greater redistribution of wealth, Nordics are just as business-friendly as the US if not more so. Examples include greater business freedoms, freer trade, more oligopolies and less of an impact on competition from state control over the economy. And as explained on page 6, while Nordics raise more taxes than the US, the gap usually results from regressive VAT/consumption taxes and Social Security taxes rather than from progressive income taxes.

The bottom line: copy the Nordic model if you like, but understand that it entails a lot of capitalism and pro-business policies, a lot of taxation on middle class spending and wages, minimal reliance on corporate taxation and plenty of co-pays and deductibles in its healthcare system.

On many measures, the Nordic approach to the private sector is even more business-friendly than the US

Sources: World Bank, OECD, World Economic Forum, Fraser Institute, KOF Institute of Switzerland and WSJ. Y axis shows relative ranking on a 0-100 scale with 100 = highest rank except for bank asset concentration, which is measured as % of industry assets for the 5 largest banks. JPMAM, 2019.

Who pays for Nordic entitlement programs? Everyone, particularly the middle class

Consumption, Social Security and Payroll Taxes as % of GDP

<table>
<thead>
<tr>
<th></th>
<th>Sweden</th>
<th>Finland</th>
<th>Netherlands</th>
<th>Norway</th>
<th>Denmark</th>
<th>US</th>
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<td>26.3</td>
<td>25.1</td>
<td>22.3</td>
<td>14.9</td>
<td>10.6</td>
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</table>

Source: OECD, 2018

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Prime Minister Lars Lokke Rasmussen, Local.DK, November 1, 2015
With Nordic countries firmly rooted in capitalism and free markets, if I wanted to find examples of democratic socialism in practice, I'd have to look elsewhere. I broadened my search and looked for countries that, relative to the US, are characterized by:

- Higher personal and corporate tax rates, and higher government spending
- More worker protections restricting the ability of companies to hire and fire, and less flexibility for companies to set wages based on worker productivity and/or to hire foreign labor
- More reliance on regulation, more constraints on real estate development, more anti-trust enforcement and more state intervention in product markets; and a shift away from a shareholder-centric business model
- More protections for workers and domestic industries through tariff and non-tariff barriers, and more constraints on capital inflows and outflows

I couldn’t find any country that ticked all these democratic socialist boxes, but I did find one that came close: Argentina, which has defaulted 7 times since its independence in 1816, which has seen the largest relative standard of living decline in the world since 1900, and which is on the brink of political and economic chaos again in 2019. Here my journey ended, halfway around the world from Scandinavia where it began. A real-life proof of concept for a successful democratic socialist society, like the Lost City of Atlantis, has yet to be found.

Michael Cembalest
JP Morgan Asset Management

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- Nordics: More taxation, with a heavy emphasis on taxation of middle class wages/spending p6
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² Sources include the World Bank, OECD, World Economic Forum, Fraser Institute, Swiss KOF Institute and WSJ.
Nordic countries: The Basics

For this exercise, we define Nordic countries as Sweden, Finland, Norway, Denmark and the Netherlands given common features of their economies\(^1\). Compared to the US, the average Nordic country is very small in terms of population and GDP, more closed to immigration, and very ethnically homogenous. Nordic per capita GDP was ~90% of US levels in both 1960 and 2018, so whatever model the Nordics adopted in the 1970's, their relative wealth didn't change much. Nordic countries rank high on surveys of prosperity and happiness; key differences vs the US include lower concerns about safety and security (see gun ownership rates below), lower defense spending (allows for more social programs) and lower concerns about environmental damage (Nordics rely more on renewable energy and nuclear power as a % of electricity generation and of primary energy use).

\(^1\) We could have included Iceland, but since its population is only 330k and its GDP is roughly the same as Fort Wayne Indiana, we decided to leave it out.
The Nordics: Market economies that are just as business-friendly as the US

Nordic countries rank even higher than the US with respect to “Business Freedoms”, which include streamlined regulations for new businesses creation, and the ease and cost of obtaining licenses and real estate development permits. Nordic countries are also more open to free trade than the US (this was true even before Trump’s tariff barriers), are more open to foreign direct investment and apply fewer capital controls. Nordics also very protective of physical and intellectual property rights, and the adverse impact of Nordic government regulation on competition is lower than in the US\(^4\). Also, consider ways that Nordic countries are even more friendly to “management” than the US: Nordics allow more market dominance by large firms, and greater consolidation in banking. Furthermore, the US scores higher than Nordic countries with respect to overseeing management misuse of corporate assets (referred to as “Conflict of Interest Regulation”), which incorporates transparency of related party transactions, access to evidence and allocation of legal expenses in shareholder litigation.

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\(^4\) Measured across energy, transport, water, telecom, professional services and retail distribution.
Another sign that Nordic countries are not following a democratic socialist model: Nordic “state control” is similar to US levels. As part of its assessment of competitive forces, the OECD analyzes the extent of state control and government regulation. One method shows that Nordic governments exercise even less state control over the economy than the US, while another shows that over time, government regulation affecting competition in critical network sectors in Nordic countries has converged to US levels¹. Either way, it’s clear from this data that the state control principles of democratic socialism (i.e., replacing private ownership with collective ownership of the means of production) are very much at odds with the Nordic free-market model.

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<th>State control of the economy (index, higher = more state control)</th>
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<td>3.1</td>
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<td>2.9</td>
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<td>Nordic avg</td>
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<tr>
<th>Competitive distortion induced by government regulation (index, higher = more distortion resulting from government controls)</th>
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<td>1.0</td>
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<tr>
<td>Denmark</td>
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Public Ownership components of OECD Product Market Regulation State Control Indicator
- Share of 30 sectors in the economy in which the state owns at least one firm
- Extent of gov’t ownership of the largest firms across six network sectors: electric, gas, rail transport, air transport, postal service and telecom
- Existence of gov’t special voting rights in privately owned firms, and constraints on the sale of the gov’t share of publicly controlled firms
- Competitive advantage conveyed to state owned enterprises that is not available to private firms; insulation of SOEs from market discipline

Energy, Transport and Communication component of OECD Non-Manufacturing Regulation Indicator
This measure covers seven network sectors (telecom, electricity, gas, mail, air transport, rail transport, and road transport):
- Entry regulation: legal conditions concerning new market entrants, legal limitations on the number of competitors allowed in the sector, terms and conditions for third party access, extent of choice of suppliers for consumers, restrictiveness of licensing systems
- Public ownership: extent of gov’t ownership in the largest energy, transport and communication firms
- Vertical Integration: degree of vertical separation between different segments of rail transport and energy sectors
- Market Structure: a measure of de-facto competition assessing (for example) the market share of the largest company within a given sector, or the total market share of new entrants

¹ The OECD’s PMR and ETCR indicators have been used by researchers to assess the impact of gov’t policies on the economy. For example, higher PMR/ETCR indicators are associated with abnormal and suboptimal profit persistence for certain firms, lower capital stock expansion and lower productivity growth. For the US, the PMR and ETCR are measured with respect to New York State. PMR indicators also portray EU countries as more regulation-intensive than they actually are, as they fail to fully take into account the benefit of streamlined regulations related to the EU internal market, according to Pelkmans (2010).
The Nordics: a higher tax burden, on everyone

The Nordic tax burden is among the highest in the world, but to be clear, Nordic reliance on regressive VAT, Social Security and Payroll taxes accounts for much more of the tax revenue gap vs the US than progressive income taxes on households and corporations\(^6\). In other words, the Nordic model is highly reliant on taxing lower and middle class spending and wages.

Note how corporate taxes contribute just 2%-3% of GDP in both the Nordics and the US, and how little Nordic countries rely on taxing capital gains of individuals, regardless of income levels. Finally, some Nordic estate tax rates are actually zero, with an average of 11% compared to US estate tax rates of 40%.

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\(^6\) Social Security taxes in the Netherlands and Denmark are based on a single rate applied up to an income cap (as in the US), or a fixed amount irrespective of income; such taxes are regressive. Other Nordic Social Security taxes apply a single fixed rate without a cap; these taxes are at best proportional, and not progressive. Furthermore, while personal income taxes in Norway/Netherlands are progressive (as in the US), in Sweden and Denmark, a flat municipal tax makes up a very large component of personal income taxes, substantially reducing their progressivity.
The Nordics: more government spending on healthcare and education, greater redistribution of income and more worker protections

Higher Nordic tax revenues support more govt spending on programs such as state-sponsored healthcare and education. On healthcare, Nordic quality and access are among the highest in the world. However, Nordic healthcare systems differ from US “Medicare for All” proposals: all five Nordic National Health Plans require patient co-payments (four of which are not contingent on the patient’s economic condition), and the three largest Nordic countries require deductibles before the govt pays for anything. This is consistent with a broader OECD trend of public plans shifting burdens onto patients. Furthermore, Nordic healthcare systems have extensive prescription drug guidelines, prescription tracking and volume monitoring, which often result in less plentiful and immediately available drugs compared to US Medicare.

Cost-sharing and cost-containment policies in Nordic and US healthcare systems

<table>
<thead>
<tr>
<th>Country</th>
<th>Use of copayment</th>
<th>Does copay depend on socio-economic condition</th>
<th>Patient deductible required</th>
<th>Prescription drug guidelines</th>
<th>Prescription pattern and volume monitoring</th>
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<td>Yes</td>
<td>Yes</td>
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<tr>
<td>US Medicare</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
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</tbody>
</table>


Access to healthcare services for diseases considered preventable (vaccine-preventable and infectious diseases; cancers, cardiovascular disease, and diabetes; and gastrointestinal conditions such as appendicitis).
On education, tuition costs at Nordic universities are ~10% of US public university costs, and even lower when compared to US private university costs. Nordic countries also provide workers with greater protections regarding the ease with which companies can hire/fire, set wages based on productivity, unilaterally set redundancy costs and hire foreign labor. Nordic unionization rates are much higher than in the US, and collective bargaining agreements are widely used across industries to a much greater degree. While Nordic countries have greater worker protections, Nordic workers earn a lower share of GDP than in the US.

The Gini coefficient is one way to measure the extent to which Nordic countries redistribute income. While Nordic inequality of earned income isn’t that different than the US, once taxes and transfers are applied, Nordic inequality falls sharply. After the impact of taxes and transfers, Nordic Gini coefficients are among the lowest in the world, and their poverty rates are less than half of US levels.
Argentina’s fall from grace, 1913 to 2018

There are two ways to look at Argentina’s decline relative to the rest of the world since the early 1900’s. The first shows the ratio of real per capita GDP in 2018 vs the same measure in 1913. Argentina’s ratio barely rose, and is the lowest ratio of all countries for which data is available for both years.

Argentina’s per capita GDP has barely doubled in over 100 years
Ratio of real per capita GDP, 2018 vs 1913

The next method illustrates how Argentina used to be among the richest nations in the world, and how far it has fallen. The x axis shows percentile of per capita GDP in 1913, while the y axis shows the same measure in 2018. All countries below the diagonal line have seen their rankings fall, while those above the line have seen their rankings improve. The farther the distance from the diagonal line, the more things have changed; Argentina’s decline from the 83rd percentile in 1913 to the 40th in 2018 is the largest decline on the chart.

Reversals of fortune: changes in per capita GDP rankings since 1913

Acronyms

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